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TAGS: ECON EINV EPET ENRG LY
SUBJECT: LIBYAN MARKET TESTS INTERNATIONAL OIL AND GAS COMPANIES

REF: A) TRIPOLI 511 B) TRIPOLI 912

¶1. (SBU) Summary: Although an alluring market for the oil and gas industry, Libya is an exceptionally difficult place in which to operate. In their daily operations, international oil companies (IOC's) face numerous challenges on visas, staffing and taxation issues, and their profit margins are comparatively narrow. The situation is likely to worsen in coming years, as Libyan authorities seek to extract additional concessions from energy companies operating in the country to maximize Libya's profits, even at the expense of continuing to attract further participation by reputable IOCs in the critical oil and gas sector that is the nation's lifeblood. End Summary.

¶2. (SBU) The results of Libya's latest Exploration and Production Sharing (EPSA) bid round, which is focused on natural gas, are due to be released December 9, and the country appears to be moving ahead with plans to develop its oil and gas industry. The National Oil Corporation (NOC) has implemented three successful EPSA bid rounds since January 2005, and has also concluded lucrative one-off deals with major international oil companies (IOCs) to develop new territories (ref A). The third (i.e., most recent) EPSA round, has attracted almost 60 companies from more than 25 countries as operators and investors. With more than forty IOCs already operating in Libya and oil prices at record highs, it would seem that the sector is the place to be in Libya; however, IOCs describe it as an extremely challenging environment that consistently tests their patience and financial limits. What follows is a summary of some of the most pressing difficulties they face; Post will outline challenges faced by oil service companies septel.

NOC TAKES A HARD LINE

¶3. (SBU) In addition to renegotiating existing agreements to extract additional concessions (ref B), the NOC is taking a hard line in a number of other areas. The general sense in the GOL appears to be that the NOC holds all the cards. NOC Chairman Shukri Ghanem put it a bit more diplomatically at the recent World Energy Congress in Rome, where he said the NOC is in a position to dictate policies that reflect "changing conditions" in energy markets. The fierce competition among IOCs to enter the Libyan market and book reserves has fed the NOC's perception that it is a seller's market. It has also led to the reality that Libya features some of the smallest profit margins in the

world for IOCs. One senior IOC official, whose company produces oil in partnership with a state-run firm, recently said his firm makes the same profit in a neighboring country in which its production is only one-quarter that of its production in Libya. That dramatic difference underscores the comparatively high operating costs for oil/gas producers in Libya and raises grave doubts about the profitability of deals agreed in the last two EPSA bid rounds, which featured razor-thin production sharing factors, reportedly as low as 6.8 percent of future production in at least one case.

¶4. (SBU) The NOC appears to be actively looking for ways to extract additional concessions, or to cut services previously provided to the IOCs. Part of this may be the result of the fact that the NOC is unable to effectively stave off other players in the bureaucracy, particularly the powerful General People's Committee (GPC) for Manpower, Training and Employment. Led by long-time cabinet minister and regime insider Matug Matug, the ministry has been one of the most active in pressuring IOC's to hire greater numbers of Libyans, many of whom are unqualified, The NOC is striking hard bargains with thin profit margins at the same time that it is asking IOCs to absorb ever-increasing costs -- direct and indirect -- for work done in Libya. The end result is a substantially more difficult and less profitable operating environment that has given IOCs pause to consider how seriously they want to pursue further concessions.

HERE, HAVE A MANAGER ... BETTER YET, HAVE TWO

¶5. (SBU) The increasingly restrictive labor regulations for IOCs and service companies, mandated by the GPC for Manpower, Training and Employment are particularly onerous. The GPC for Manpower recently directed that for every new expatriate hired by an IOC, one Libyan must be added to the company payroll as

well. It is required that certain key positions in IOCs' local offices - deputy country manager, finance manager and human resources manager - be staffed by Libyans. Companies have tried various ways to comply with these requirements, from hiring competent managers away from NOC-run companies to hiring and immediately marginalizing an "empty suit" employee. Other tactics include adding a lightly disguised expatriate layer atop the position encumbered by a Libyan and stalling with respect to encumbering positions designated for Libyan nationals. Expatriate IOC representatives consistently bemoan the time and training required to bring new Libyan hires up to speed; a lack of candidates with professional fluency in English and other basic skills is a persistent problem. IOC managers stress that they invest considerable time and resources training locally-engaged staff everywhere in the world; however, they describe Libyan employees as being less able upon hiring than most, necessitating longer, more costly training.

VISA WOES CONTINUE TO RANKLE

¶6. (SBU) At the heart of the IOCs' struggle to succeed in Libya's difficult operating environment is the constant difficulty of obtaining visas and work permits. The NOC has increasingly used visas and residency permits as a tool by which to enforce compliance with the "hire Libyan" policy, refusing to issue visas or residency permits to expatriates encumbering deputy manager, finance manager or HR manager slots. Expatriate employees often have to leave the country as their residency permit runs out and remain outside the country for weeks or months while their company works to get the permit renewed. Many companies are forced to use two-week business visas, which may be renewed twice, for up to six total weeks in country. The Byzantine visa requirements put a tremendous administrative burden on IOCs, which typically maintain up to a half-dozen locally-engaged employees to work on nothing but visas and residency permits. The GPC for Manpower's edict that a new Libyan employee be hired for each new expatriate hired has an additional, visa-related wrinkle: for each renewal of a one-year visa for an expatriate employee, an additional Libyan employee

must be hired. An expatriate employee staying on for three years could be accountable for the addition of four Libyan employees (one counterpart at hiring plus one for each visa issued). The NOC reportedly opposes this requirement, but has been trumped by the GPC for Manpower.

THE TAX MAN COMETH

¶7. (SBU) Various arms of the Libyan government are also working to extract additional tax revenue from energy sector activities. This is reflected in the imposition of a two percent "Stamp Tax," which will be assessed on all contracts falling under the December EPSA round and all new contracts signed after that. This tax has been sporadically applied to other areas of the economy, specifically where foreign investment is involved, since it first appeared on the books in 1955. An effort by the Libyan Tax Authority to collect it on contracts under previous EPSA rounds was successfully contested by the affected companies, leading to the Tax Authority's announcement that all future contracts would be subject to it. There is also a move afoot to extract additional tax revenue from offshore exploration and drilling. The GOL had previously allowed the servicing of these activities out of Malta, but is now moving to curtail that and to require that they be based out of Libya. The relocation of onshore support services for offshore operations generates considerable income for the Tax Authority; offshore drilling operations can cost up to $750,000 per day for deep-water operations. In addition, the NOC recently decided it would no longer act as an intermediary between the IOCs and the Tax Authority. IOCs have been forced to hire additional staff and devote considerable resources to parsing through Libya's amorphous tax system to determine what their obligations are and how to meet them.

RISING SALARIES GUTTING STATE-RUN COMPANIES

¶8. (SBU) Libya's state-owned companies continue to protest what they consider to be unreasonably high rates for expatriate labor, and have attempted to hold a line at the rate schedule employed in 2002 during the sanctions period. Overall salaries

have risen about ten percent for each of the past two years, but the state-owned operator oil companies (e.g., Waha, Zeuitina) still lag well behind the IOCs in terms of compensation. They are accordingly hemorrhaging seasoned workers, who are taking advantage of high international demand for oil/gas worker to leave Libya for more lucrative opportunities in the Gulf and elsewhere. As the state-run firms fail to offer competitive wages for expatriate workers, they are unable to fill current vacancies. An example is the state-run firm Waha, which has at least 100 expatriate vacancies at present, constituting roughly one third of its expatriate workforce. The situation affects not only these companies and the NOC, but also the IOCs that depend on state-run firms as operating partners. This is the arrangement for almost all companies engaged in production and export activities. The GOL's decision (under Law No. 43 of 2006) to pull back the NOC's procurement offices in London and Dusseldorf (Umm Jawaby and Medoil, respectively) also creates problems for state-run firms, which have had their supply lines interrupted by the disruption of a long-established logistics system and the ongoing movement of more than two hundred state employees from Europe back to Libya.

¶9. (SBU) Comment: Libya's oil and gas sector is in many respects the bellwether for the rest of its emerging economy. The fact that IOCs, which successfully operate in some of the most forbidding environments in the world, are having such a difficult time underscores how far the GOL has to go in terms of reform if it is to achieve its stated goal of attracting greater foreign investment and commercial interest to Libya. We consistently hear expressions of disappointment from senior GOL officials that more U.S. firms have not rushed to enter Libya's market since sanctions were lifted and Libya was removed from the state sponsors of terrorism list. Pernicious requirements such as the "one expat-one Libyan" hiring policy and capricious

visa policies, however, do nothing to encourage other U.S. and foreign companies with less international experience than the IOCs to enter the Libyan market. End comment.
STEVENS